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FEDERAL COMMUNICATIONS COMMISSION
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FCC MAIL BRANCH

May 12, 1993

Ms. Donna R. Searcy, Secretary
Federal Communications Commission
1919 M Street, NW
Washington, DC 20554

Re: FCC 93-126; CC Docket No. 93-50 - Accounting and Ratemaking Treatment for the Allowance for Funds Used During Construction (AFUDC), Notice of Proposed Rulemaking.

Dear Secretary Searcy:

The Public Service Commission of Wisconsin (PSCW) appreciates the opportunity to comment on the above-referenced notice of proposed rulemaking. The PSCW comments will cover three issues:

1. The appropriate rate to use to compute AFUDC;
2. Differences between long-term and short-term plant under construction; and,
3. Including plant under construction in rate base.

PSCW Method

For regulated utilities, where rates are set to recover the return required on equity as well as the cost of borrowing, the PSCW view has been that capitalization of AFUDC should reflect the cost of all funds related to the construction activity, whether debt or equity. Due to the difficulty in associating a specific source of funds with a specific project, because of the many and varied sources and uses of funds, the capitalization rate used by the PSCW is generally determined by the utility's weighted cost of capital as adjusted for the ratio of utility net investment rate base plus plant under construction to capital applicable to utility operations plus deferred investment tax credit. The capitalization rate is generally applied to the average funds invested in construction (i.e., the average plant under construction) not earning a current return. This methodology is applied to all gas, electric and telecommunications utilities. Due to the immaterial difference in the impact of using the weighted cost of capital versus the prime rate, Wisconsin Bell, Inc. (WBI), was allowed to use the

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prime rate of interest. This approval was conditioned on the ongoing monitoring of the prime rate and an evaluation of the use of the prime rate in the next WBI rate proceeding.

Where a specific new borrowing has been associated with the asset under construction, the PSCW has allowed the use of that borrowing to determine the cost of capital to be capitalized. Given the premise that the borrowing is specifically for this construction project, the entire interest cost of the borrowing is capitalized.

The general PSCW policy is to accrue AFUDC on long-term construction projects and not allow a current return on such projects. Generally, short-term projects either earn a current return or accrue AFUDC, but not both. In making its decision, whether or not to allow a utility to earn a current return on short-term plant under construction, the Commission considers each utility's level and quality of earnings, construction requirements, and cash flow requirements.

AFUDC Rate

The FCC proposal in this docket uses the cost of debt on all construction for the capitalization of AFUDC. The cost of debt proposed by the FCC is in accordance with Generally Accepted Accounting Principles (GAAP) requirements, as set forth in Statement of Accounting Standards (SFAS) number 34, Capitalization of Interest Cost, and its amendments.

The PSCW's preferred rate for recording AFUDC is the weighted cost of capital, not the cost of debt. This is the position that was stated by Ameritech in its Petition for Rulemaking, dated January 11, 1991. Use of the cost of debt as an AFUDC rate is incorrect from a regulatory policy perspective. It results in current customers paying costs incurred to benefit future customers.

The question that needs to be answered, regarding the rate to be used to compute AFUDC, is whether conformity with GAAP should prevail over consistency with regulatory needs. This was recognized by the FCC in docket 84-469. In that proceeding the FCC adopted GAAP in the USOA to the extent possible consistent with regulatory needs. The FCC proposal to use the cost of debt is essentially to obtain conformity with GAAP. Paragraph fifteen of the FCC Notice of Proposed Rulemaking states,

> "Consistent with the policy set in Docket 84-469, we prefer the use of GAAP in our accounting rules. We prefer also that our ratemaking requirements be consistent with

our accounting rules. Such conformity will enhance the utility of the data reported for regulatory purposes. Further, a single method that is consistent with GAAP can be expected to simplify accounting and reduce shifted onto current ratepayers that will benefit future ratepayers.

The magnitude of the difference that would be caused in rates is not currently large in the telecommunications industry as plant does not require long periods of time to construct. However, it is very significant at times in other industries such as the electric industry. This is important to recognize as the FCC deals only with telecommunications, whereas the PSCW, as a state regulatory agency, needs to consider the potential impact if such a policy is applied to all utilities. The Commission needs a basis for making a distinction between using one AFUDC rate for one industry and a different AFUDC rate for another industry.

Long-term Versus Short-term Plant Under Construction

The FCC proposal eliminates the difference in treatment between long-term and short-term plant under construction. Like the AFUDC rate based on the cost of debt, this part of the FCC proposal is also essentially to obtain consistency with GAAP.

In 1967, in Docket 16258, the FCC concluded that long-term construction projects generally benefit only future ratepayers. The FCC, therefore, found that such projects should not be paid for by current ratepayers. For short-term construction projects, the FCC determined that since the duration of the projects was relatively short and most current ratepayers would still be ratepayers when the projects are completed, it was neither practical nor necessary to distinguish between these current and future ratepayers.

The PSCW believes that nothing has changed since 1967 regarding the differences between long and short-term construction projects. The reasons used by the FCC to differentiate between long and short-term construction projects in 1967 still exist today and are still appropriate. The PSCW, therefore, based on regulatory needs believes that the proposed elimination in treatment between long and short-term construction projects is not justified.

Ratemaking for Plant Under Construction

The final part of the FCC proposal is to include all plant under construction in rate base in addition to accruing AFUDC. The amount of AFUDC capitalized will be applied as a revenue requirement reduction for the period it is capitalized.

In normal circumstances, while it is desirable for a state's accounting policy to be consistent with the FCC's accounting policy, it is not essential for a state's ratemaking policy to be consistent with the FCC's ratemaking policy. It is more important that the state's ratemaking policy is in the public interest and is consistent among all utilities within that state's jurisdiction. In this docket, however, the FCC is proposing to make its accounting policy for AFUDC consistent with its ratemaking policy. The FCC proposal makes it difficult for each state to keep its current ratemaking policy, if the state wants to make its AFUDC accounting policy consistent with the FCC.

As stated previously, the use of the cost of debt to compute AFUDC does not allow the investors to recover the total cost of construction. For the Wisconsin Commission to only adopt the FCC's proposal for accounting for AFUDC using the cost of debt, the investors will be harmed since they will be unable to recover the full cost of construction (i.e., the portion of construction funded by equity). To properly compensate the investors, this Commission would be forced to adopt a policy consistent with the FCC's ratemaking treatment, and allow a current return on all plant under construction. This would cause an inconsistency in ratemaking treatment for telecommunications utilities and energy utilities, and also among individual telecommunications utilities, when one utility requests approval to adopt the FCC AFUDC policy and the other telecommunications utilities continue the PSCW policy.

In addition, in any rate proceeding the current PSCW policy is to evaluate whether or not to allow a current return on plant under construction. In making this decision, the Commission considers each utility's level and quality of earnings, construction requirements, and cash flow requirements. Following the FCC policy as proposed would eliminate each state's decision making flexibility.

Conclusion

These comments are filed because the FCC proposal represents a significant determination for utility accounting and ratemaking. Should GAAP dictate to regulators how to allocate costs equitably between periods to different generations of ratepayers? Or should regulators acknowledge that under certain circumstances the goals of regulatory accounting will place a greater emphasis on equitable intergenerational allocation of costs than GAAP does and choose accounting methods in keeping with regulatory needs?

This is not to imply that such a divergence in accounting should occur frequently. It is important to limit the circumstances under which regulatory accounting differs from

GAAP. It is also important for investors to be fully informed of differences between regulatory accounting and GAAP. The FCC's decision to adopt GAAP in the USOA to the extent possible consistent with regulatory needs is reasonable. Generally, Wisconsin has tried to keep its accounting the same as the FCC for both investor understandability as well as reducing the need for costly side records. Based on the specific circumstances in this docket, however, the PSCW does not believe that adopting